84-11E

Current Issue Review

Canada - U.S. Trade Policy Issues: Free Trade Discussions

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16 April 1984
Reviewed 26 March 1987

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Cat. No. YM32-1/84-11-1987E

ISBN 0-660-12604-4

N.B. Any substantive changes in this Review which have been made since the preceding issue are indicated in **bold print.**

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CANADA - U.S. TRADE POLICY ISSUES: FREE TRADE DISCUSSIONS

ISSUE DEFINITION

The issue of free trade between Canada and the United States is as old as Canada itself. It has been one of the oldest ongoing debates in Canadian history and has been called "the issue that won't die." Currently, Canada is undergoing perhaps the most comprehensive consideration of the idea in this century. While much of the current debate is only the latest version of the traditional or standard arguments, it is supplemented with one new element: the governments of Canada and the U.S. have been undergoing internal discussions of meetings in order to determine if further trade liberalization between the two countries is possible. The purpose of this issue review is to outline the current state of these talks. The first section of the paper will briefly outline Canada-U.S. trading patterns. This will be followed by a review of the talking points that have emerged in recent months from the discussions.

It is essential to begin any discussion of free trade with a definition of what is meant by the term. For the purposes of this paper, a free trade agreement implies the removal of as many tariff and non-tariff impediments to trade in goods and services between Canada and the U.S. as is possible. A free trade agreement is the loosest form of economic integration. The next step towards full economic integration would be a "customs union" which entails the joint commitment to apply identical tariff and non-tariff barriers against the exports of other countries. Should this prove acceptable, the next step would be a common market where there would be free movement of goods, services, capital and labour. A

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common market would naturally give rise to considerations of a common currency and the harmonization of each country's policies in the areas of regulation, subsidization, tariff-protection and taxation of industry. A successful common market might lead to considerations of a political union as well, since political integration would be the next logical step in this sequence. However, the term free trade agreement is meant to include a comprehensive agreement to remove as many barriers as possible to the free movement of goods and services between Canada and the U.S.

BACKGROUND AND ANALYSIS

In order to place the current negotiations in their proper context it is necessary to understand the existing trading relationship. For sheer size and importance, Canada-U.S. trade is greater than that of any other bilateral trading relationship in the world. Each country is the other's largest trading partner and the flow of goods and services is among the least restricted in the world.

First, a profile of Canada's trade: in 1986, Canada exported $149.5 billion worth of goods and services to all countries.(1) Of this, the United States accounted for $109.1 billion or 73.0% of the total. Merchandise makes up the greatest share of trade with goods exports to all countries amounting to $120.6 billion in 1986, of which $93.6 billion went to the United States, a decrease of 0.8% from the 1985 level of $94.3 billion. The share of Canadian merchandise exports destined for the United States has varied over time, reaching a ten year low of less than 64% in 1980. It has since risen to 77.6% in 1986 and has averaged over 70% during the past decade.

With respect to imports of both goods and services, Canada imported about $158.3 billion in 1986 from all countries.(2) Some $103.7

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(1) Based on quarterly estimates of the balance of payments including transfers, investment receipts and remittances.

(2) Based on quarterly estimates of the balance of payments including transfers, investment payments and remittances.

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billion, or 65.5%, originated in the United States. Merchandise imports from all countries were $110.5 billion in 1986 with $76.8 billion coming from the United States, up 4.3% from the $73.6 billion registered in 1985. During the past decade, the United States has been the source of about 70% of all Canadian goods imports (on average). This has ranged from a low of 68.4% in 1981, to the highest point in 1979 when a 72.7% share was recorded. Approximately 2.5 million jobs in Canada depend upon trade with the United States.

In a similar fashion a description of U.S. exports and imports shows Canada has traditionally been the largest market for U.S. exports and the largest source of imports. (However, in 1986, U.S. imports from Japan exceeded those from Canada.) The share of U.S. exports destined for Canada appeared to be declining in the late 1970s and early 1980s, reaching a low during the 1982 recession. With the recovery in 1983, however, the resurgence of Canadian demand began drawing in more American products and in 1986, 24.5% of U.S. goods exports were being shipped to Canada.

Imports by the U.S. of Canadian goods accounted for 19.0% of total U.S. goods imports in 1986 while 21.9% came from Japan. During the last recession, Canada not only maintained its exports to the U.S., but also managed to increase its relative share slightly.

The leading Canadian merchandise exports to the U.S. are: passenger autos and chassis; natural gas; newsprint and other paper; motor vehicle parts, except engines; trucks, truck tractors and chassis; crude petroleum; petrochemicals and hydro-carbon products; pulp; softwood lumber and precious metals. The top U.S. merchandise exports to Canada are motor vehicle parts; passenger autos and chassis; computers; motor vehicle engines; trucks, truck tractors and chassis; and aircraft.

One feature of Canada's trade with the U.S. is that the Canadian exports contain proportionately more end-products than our exports to other countries. However, this is primarily due to trade conducted under the terms of the Auto Pact as automotive products currently account for almost one-quarter of Canada-U.S. trade.

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A. Benefits and Costs of Free Trade with the U.S.

There have been many studies of the economic gains Canada would derive from a Canada-U.S. free trade agreement. The underlying assumptions of these studies are derived from the classical theory of international trade which asserts in its basic form that international trade benefits all participating countries as it allows for the most efficient use of resources and thus creates a higher income level than any one country could attain should it choose not to trade. This theory holds regardless of the size of the trading partners. Also, it is believed that the smaller country stands to gain more than the larger country as the smaller country gains access to a larger market.

In general, there are four economic benefits that Canada would obtain in a free trade arrangement with the U.S.: (i) it would permit Canadian manufacturing plants to be rationalized and economies of scale to be achieved; (ii) it would encourage more rapid technological diffusion within an industry as well as more research and development because Canadian-based firms would have free access to a much larger market; (iii) it would stimulate greater all-round efficiency through the exposure of Canadian industry to greater competition; and (iv) it would increase specialization which would enable Canada to exploit its comparative advantage more fully. Also, there is a major political benefit; namely, that it would eliminate Canada's present vulnerability with respect to U.S. protectionist measures.

These economic benefits come from two reinforcing processes. In simplest terms, one could think of a "carrot-and-stick" analogy. The carrot would be the changes Canadian firms would make in order to take advantage of the access to the U.S. market. The stick would be the changes forced upon Canadian firms from the increased competition they would encounter from U.S. firms. In both instances, Canadian companies would be forced to rationalize their production processes. It is widely recognized that Canadian factories have shorter production runs and produce a greater variety of products than similar plants located in the U.S. The rationalization process that would be set in motion via a free trade arrangement would lead Canadian firms to specialize in a smaller

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range of goods, producing each at a higher volume and at lower cost. The reduction in costs would mean greater productivity for each firm and the increase in productivity would enable producers to increase the wages they pay their workers.

The removal of existing U.S. tariffs (as well as the commitment not to reintroduce them) would encourage Canadian companies to increase their sales to the U.S. or to attempt to sell in that country, if they are not already doing so. Some Canadian producers would be able to penetrate the U.S. market if they could capture the economies of scale that occur at certain production levels. The Canadian market by itself is not large enough to encourage Canadian firms to specialize in particular product lines. The removal of the U.S. trade barriers would encourage firms to undertake the reorganization costs necessary to scale up for the North American market. Even without any enhancement in domestic productivity, the removal of trade barriers would reduce the price at which Canadian firms can sell in the U.S. and hence improve their competitiveness.

The benefits from free trade with the U.S. would also differ from the short run to the long run. The short run benefits are of the kind mentioned above, namely the lower-priced goods for consumers, and increased exports to the U.S. due to the removal of trade barriers which both hinder and distort trade flows.

The longer run benefit would be the improvement in the efficiency and productivity of Canadian firms. Trade liberalization would make Canadian firms more competitive in world markets. The investments needed to keep Canada abreast of the technological revolution will have to be made within the next decade. Freeing trade between Canada and the U.S. would point Canadian industry in the right direction for these investments.

B. Costs of Free Trade

Critics of a Canada-U.S. free trade agreement believe that the benefits Canada would receive would be much smaller than the costs. As well, they argue there is bound to be either a loss or significant decrease in Canada's sovereignty. In particular: (i) Canadian manufacturing

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industries enjoy few comparative advantages vis-à-vis the U.S. Consequently, the removal of tariffs would simply lead to the replacement over time of Canadian manufacturing production by American; (ii) the large degree of foreign ownership in Canadian industry would, through the operation of "boardroom prejudices", tend to result in Canadian production being relocated in the U.S. even when Canadian production costs might be lower; (iii) the rationalization of Canadian industry which would occur in a free trade arrangement, when combined with Canada's comparative advantage in natural resources, would leave Canada in a position of being a "hewer of wood and a drawer of water."

The critics of free trade believe that its advocates have consistently over-estimated the benefits of free trade while underestimating the transition costs that would be incurred during the adjustment period. In addition, the studies promoting free trade as a desired policy objective overlook the dangers of a free trade arrangement leading to a political union with the U.S. or at least making the Canadian economy vulnerable to policy shifts in the U.S.

The critics of free trade do not dispute the economic processes that would be set in motion by a free trade arrangement. There is a consensus that Canadian manufacturing needs to be made more productive and hence competitive in the world economy. As well, the importance of exports to the growth of Canadian economy is widely accepted as is the necessity of ensuring that Canadian industry modernize itself so as to be able to maintain its export sales. However, critics maintain that a comprehensive industrial strategy could achieve these objectives without the adjustment costs of a bilateral free trade agreement.

Under bilateral free trade, the major restructuring and adjustment would occur in the secondary manufacturing industries, not the primary and resource-related processing industries. The latter industries are already exporting on a world-wide scale so there would not be as much rationalization as in manufacturing industries.

Free trade will not necessarily mean firms in Canada will engage in more research and development simply because firms have free access to a larger market. The U.S. firms with branch plants in Canada

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already conduct lower levels of R & D than similar Canadian firms. Under a free trade arrangement there will be even less incentive for them to undertake these activities in Canada. The Auto Pact provides a useful illustration in this area. The Auto Pact is often cited as an example of the type of free trade agreement Canada would seek with the U.S.(1) However, none of the large U.S. automotive manufacturers conducts substantial R & D in Canada. Critics of bilateral free trade believe that this pattern will be found in any sector where there is bilateral free trade.

Advocates of free trade claim that the efficiency of Canadian industry would be improved by the exposure to more competition. However, efficiency is determined by more than just the levels of protection an industry has. Institutional factors such as the attitudes of labour, the state of labour-management relations, and the state of government-industry relations are also important. For instance, it is for these reasons that the efficiency of British industry has not improved as much upon Britain's entering the European Common Market as was predicted.

One of the benefits that it is claimed would occur under bilateral free trade is the rationalization and specialization of production in Canada. However, tariff barriers have been falling for many years to the point where 80% of Canada's exports to the U.S. will be duty-free by 1987 and a further 10% will have rates of duty at levels of less than 5%. During this period of falling tariff barriers, most Canadian firms have not reacted by becoming more specialized nor have they attempted to increase their exports to the U.S. This behaviour suggests that the economic benefits from the rationalization and specialization of production induced by bilateral free trade may not be as strong as advocates of free trade claim.

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(1) Leaving aside the question of whether the U.S. will accede to this type of agreement. In particular, the U.S. has repeatedly stated that Canada cannot expect that the "safeguard" clauses of the Auto Pact will be extended to other industries.

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One of the major questions on the potential costs of bilateral free trade concerns its impact on Canadian sovereignty. There is no consensus on this point. One view is that a bilateral free trade arrangement with the U.S. would be an irreversible step on a road that ultimately would lead to political integration with the U.S. This opinion was explicit in the Trudeau Government's "Third Option" paper presented by Mitchell Sharp and provided the impetus for a decade-long attempt to reduce Canada's dependence on the U.S. market. The relationship between Belgium or Holland and the EEC has been cited as an example of closer economic relations not necessarily leading to political integration. However, this precedent does not fit the North American situation exactly as the U.S. is much more dominant in the North American economy than any single country in Europe. The smaller countries in the EEC are dealing with a number of countries within the EEC, none of which is as predominant as the U.S.

The uneven size and strengths of the Canadian and U.S. economies mean that major decisions would be made in Washington and Canada would have little bargaining power. It is possible the U.S. could use Canada's reliance on the U.S. market (or vulnerability) to restrict Canadian independence in other areas. Examples of this might occur if the U.S. decided that Canadian policies with respect to regional development or foreign ownership were unacceptable. Although this might be an exaggerated concern, the enactment of bilateral free trade would be almost irreversible and Canada must be prepared for these eventualities.

C. Changing Circumstances

The above discussion of the gains and losses from a Canada-U.S. free trade arrangement is familiar and the arguments pro and con have not changed substantially for two decades. If this is the case, why has the issue attracted such widespread notice in the last couple of years? There are several reasons for this.

Increasing protectionist sentiments and actions around the world have revealed Canada's vulnerability. Canada is the only major industrialized country which does not have access to a market of at least 100 million people. The figure 100 million appears to be the minimum size

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needed for an economy to exploit fully the new technologies and achieve economies of scale. The U.S. Administration is, at heart, essentially in favour of trade liberalization but it is encountering increasing protectionist claims in the Senate and the House of Representatives. The Japanese market is difficult to penetrate at best and seemingly almost impossible in the areas of most interest for Canada. The EEC appears to wish to concentrate on resolving its internal disputes - the largest of which concerns the distortions caused by its Common Agricultural Policy.

Canada's preferred option for trade policy since the Second World War has been the trade liberalization conducted under the auspices of the GATT. However, the GATT negotiations may not be conducted quickly enough or involve all the issues of most interest to Canada. For instance, the Tokyo Round of trade negotiations begun in 1973, was completed in 1979 with the tariff reductions to be fully implemented by 1987. At a similar rate, the next round of negotiations (which would be even more complex and difficult) would not be fully implemented until the next century.

The difficulties facing the GATT stem from two sources. One, the institution itself is becoming increasingly unwieldy. Currently, there are 122 members of the GATT. The interests of all these countries are difficult to reconcile due to a combination of "free riders" (countries that wish to benefit from agreements without giving anything up in return) and "foot draggers" (countries that do not wish to negotiate certain issues and consequently stall negotiations).

The second difficulty facing the GATT is that the issues are becoming increasingly complex and difficult to negotiate on a multilateral basis. For instance, the issues of most interest to Canada - effective rules to govern non-tariff barriers to trade, negotiations to liberalize trade in agriculture and services and actions to maintain (or enforce) a liberal world trading order - could not be resolved satisfactorily during the Tokyo Round of negotiations. Will the new round of GATT talks be more successful?

As well as international circumstances, there has been a major change in the support for a free trade arrangement within Canada. Representatives of the business community have become advocates of such an

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agreement. The Canadian Manufacturers' Association has traditionally been against a free trade agreement but it has now joined the Business Council on National Issues and the Chamber of Commerce in urging the federal government to begin negotiations on this subject.

As well, there have been changes in provincial positions. Historically, the Western provinces and the Atlantic provinces have supported freer trade with the U.S. This position can be traced back to Sir John A. Macdonald's National Policy which these regions perceived as benefiting Central Canada (Ontario and Quebec) at their expense. Ontario and Quebec, on the other hand, have traditionally been reluctant to support a free trade arrangement as they perceived that the adjustment costs would be too high. Quebec has recently changed its position, however, and Ontario and Manitoba remain the only provinces whose leaders are reluctant to liberalize trade between Canada and the U.S.

The general change in attitude towards free trade can also be found at the federal level. The release of a review of Canadian trade policy two years ago by the then Minister for International Trade, the Hon. Gerald Regan, was interpreted in two ways. First, it was widely regarded as the "death certificate", or official recognition of the end of the Third Option. The Third Option was first proposed by Mitchell Sharp in 1972 and it was intended to reduce Canada's dependence upon the United States by increasing Canada's trade with Europe and Japan. The Canadian government hoped that the signing of a "Contractual Link" with the EEC in 1976 would bring substance to the Third Option. However, despite these attempts to divert trade throughout the 1970s, at the end of the decade Canada was trading even more with the U.S. than it had been at the beginning.

The documents also sanctioned the possibility of Canada's negotiating a series of "sectoral" free trade agreements with the U.S. Discussions were begun in the fall of 1983 concerning the possibility of Canada and the U.S. reaching agreements to enact free trade in the following sectors: steel, urban transit, agricultural machinery and computer services. The model for these agreements would be the Auto Pact. In order to qualify for GATT exemptions, these sectoral agreements would be

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open-ended and any country wishing to join could do so by signing the agreement. It was hoped that the sectoral discussions would provide an example by which a larger multilateral trade liberalization could be undertaken. It is increasingly apparent, however, that the sectoral approach to free trade has come to a halt. The main reason appears to be that the negotiations required by a sector-by-sector approach would take too long and be too complex. An across-the-board approach to free trade is easier to negotiate as it offers more room for political manoeuvring and compromise.

In March 1985, Prime Minister Mulroney and President Reagan met at the Quebec City Summit. Although the meetings covered many topics of mutual interest, trade issues were featured prominently. A communiqué, entitled "Declaration on Trade in Goods and Services", was released which dealt with specific trade irritants and established a work program aimed at improving the trading relationship between the two countries.

The Honourable Joe Clark released a Green Paper entitled, Competitiveness and Security: Directions for Canada's International Relations in May 1985. This document represented a comprehensive examination of the complete range of Canada's external relations. All Canada-U.S. relations were discussed and the idea of closer economic relations with the U.S. was held out as a possibility that should be examined (although there were no specifics mentioned).

This document led to the creation of the Special Joint Committee on International Relations which was given the task of conducting hearings on the issues raised in the Green Paper. The Committee's first Report, entitled The Interim Report pertaining to Bilateral Trade with the U.S. and Canada's Participation in Research on the Strategic Defense Initiative was released on 23 August 1985. One of its major recommendations was that "there be immediate bilateral trade discussions with the U.S." which would be aimed at resolving current trade irritants and would "explore the potential for additional trade liberalization between the two countries." However, the Special Joint Committee did not recommend that Canada should negotiate a free trade agreement with the U.S. as this would be "premature."

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The Report of the Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission) was released 6 September 1985. Among its many recommendations, was one that Canada should begin immediately to seek a free trade agreement with the U.S.

Prime Minister Mulroney announced at a press conference on 26 September 1985 that Canada would begin exploring the possibility of negotiations which might lead to a comprehensive trade agreement between the two countries. The Honourable Joe Clark was designated as the Minister who would be in charge of coordinating the Canadian initiative.

President Reagan referred the Canadian request for exploratory talks to the U.S. Congress on December 18. The Senate Finance Committee (Robert Packwood, Chairman) had 60 working days in which to respond to the President's request to begin the discussions. The Committee vote was taken on April 23, 1986 although it had been postponed for one day (when it appeared that the Administration request would be refused). The outcome was a split vote of 10-10. Although this amounted to a granting of negotiating authority to the Administration, it was not an auspicious launch to the discussions.

The debate in the Senate Finance Committee only indirectly involved Canada-U.S. trade issues. At the heart of the politically-charged proceedings was the Senators' frustration with the Administration's overall trade policies. The Senators believed the President was not doing enough to stem the flood of imports into the U.S. which is eroding the traditional manufacturing base of the U.S. economy. The Senators frequently referred to subsidies or other unfair trade practices of the U.S. major trading partners - especially Japan but also the EEC. In addition, the Senators did not believe the Administration was consulting them on trade policy in a fashion consistent with the Senate's undisputed constitutional responsibilities with respect to foreign treaties and agreements. The "fast-track" process is one irritation in this regard.

Under the "fast-track" provisions, any treaty which might result from the Canada-U.S. discussions would be referred to the Senate which would have 90 days to consider it. However, the Senate would not be able to amend the treaty in any way. Any attempts to amend it would be

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tantamount to its rejection. The Senators believe they should be able to vote more than "yes" or "no" on treaties. However, it is just this involvement by the Senators in treaty negotiations that Canada, along with other countries does not want. The partisan nature of the U.S. Senate has, in the past, meant that the foreign country is put under pressure to make concessions additional to those agreed to during the treaty negotiations. This so-called "two kicks at the can" is what the Senate wants as it allows them to review and amend foreign treaties entered into by the Administration. For the same reason other countries do not want the Senate to reopen negotiations already agreed to by the Administration.

The vote on the U.S. Administration's negotiating authority was used by the Senate Finance Committee to register its complaints about the President's overall trade policies and the way in which the Senate is losing its ability to amend foreign treaties in general (due to "fast-track" procedures in trade and other areas). One result is that the President will probably have to increase his consultations with both branches of the Congress in the future so that his ability to conduct negotiations is not undermined by any difficulties in getting treaties ratified by the Senate.

Ironically, the widely-publicized vote in the Senate Finance Committee served as an illustration of one of the problems the Mulroney government is hoping a freer trade agreement with the U.S. will resolve. Canada's access to the U.S. market is only guaranteed by the obligations the U.S. has accepted under the GATT. Despite Canada's overwhelming dependence on this market, there are no special arrangements which give Canada any shelter against protectionist sentiments and actions in the U.S. Also the U.S. Congress is the main forum for those seeking protection to state their case. The Canadian government is seeking a more secure access to its most important market before protectionist measures are put in place - measures many of which are not aimed at Canada, but of which this country would be a victim.

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D. The Free Trade Negotiations

The long-awaited Canada-U.S. negotiations on freer trade between the two countries were launched in Ottawa on May 21, 1986. The historic meeting was the culmination of a series of events which can be traced back to August 1983 when the Liberal government of the day indicated it was considering placing a higher priority on Canada-U.S. economic relations. The Canadian negotiating team is headed by Simon Reisman while Peter Murphy leads the U.S. negotiators.

Chief negotiators for both sides appear to be "happy" with the results so far despite the increasing trade frictions and the generally pessimistic outlook of some. Earlier reports indicated that topics discussed included: intellectual property rights, customs harmonization, trade in services, government procurement, agricultural issues, and countervailing and antidumping duties. Canada stated that cultural and social programs are not up for discussion. Ten working groups and two fact-finding teams were established by the negotiating teams to deal with individual topics on the agenda and these groups are scheduled to report back to subsequent meetings between the two teams.

At the sixth meeting between trade negotiators, held in Ottawa, November 12-14, the progress of the working groups and fact-finding teams was reviewed. Some of the issues apparently examined by the working groups were among the topics discussed in earlier rounds of negotiations including: customs procedures, services and patents and copyrights. One of the fact-finding groups is analyzing investment in the automotive sector involving Canadian duty relief measures which are attracting overseas automakers to this country. Services and trade-related investment should also be on the free trade negotiations agenda.

Another round of negotiations took place in Washington between December 16-18, with both sides stressing the need to work expeditiously in order to have an agreement ready to place before the U.S. Congress by October 1, 1987. This would give Congressional politicians the

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90 days allotted to consider it before President Reagan's negotiating authority expires January 3, 1988.

After holding a one-day meeting on January 15, 1987 with chief U.S. trade negotiator, Peter Murphy, Canada's chief trade negotiator, Simon Reisman, met the next day with U.S. Treasury Department officials in Washington to discuss the removal of barriers to trade in financial services such as banking, insurance and the securities business. The proposal by the Ontario Government to let foreigners own up to 100% of Canadian securities dealers in the next two years removed a Canadian "bargaining chip", according to Mr. Reisman. The chief U.S. trade negotiator, Peter Murphy, was not included in these discussions, as the U.S. Treasury Department has claimed jurisdiction over trade in financial services.

The free trade negotiations received a boost when four U.S. Senators from the powerful U.S. Senate Finance Committee visited Ottawa on December 9, 1986. The new Democratic chairman of the Committee, Senator Lloyd Bentsen, stated his belief that "the chances are very good that we can work out an agreement." All four Senators, two of whom had voted in April 1986 against proceeding with free trade talks on a fast-track basis, expressed their support for an agreement. This helped dispel some fears that the recently-elected Democratic-controlled Senate would block a free trade agreement with Canada.

Further evidence of American interest in the talks was received on January 21, 1987 when U.S. Vice-President George Bush and Treasury Secretary James Baker visited Prime Minister Mulroney in Ottawa, at his invitation. The Prime Minister encouraged the U.S. Administration to give the free trade negotiations a higher priority. The Vice-President took note of the Prime Minister's request and promised to raise the issue with President Reagan. He also stated that the free trade discussions are regarded by the U.S. Administration as "very important" and "very possible to bring to fruition."

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The Prime Minister's concern over the apparent lack of attention shown the free trade negotiations by the U.S. administration was evidently relayed to President Reagan. In the President's State of the Union address to the U.S. Congress on January 27, he promised to "complete a historic free-trade arrangement between the world's two largest trading partners - Canada and the United States." The statement was significant as a message to the Canadian government regarding the seriousness of the U.S. administration's intentions, but also as a signal to the Congress and the U.S. bureaucracy that Canada-U.S. free trade is definitely on the administration's agenda. The higher profile given the free trade negotiations was reinforced when it was reported that U.S. Deputy Treasury Secretary Richard Darman had disclosed that achieving a free trade pact with Canada had been identified by the U.S. Cabinet as one of two major goals for the last two years of President Reagan's administration.

Less helpful to the Canadian government's case for free trade, were comments by U.S. Trade Representative Clayton Yeutter, who stated that he was prepared to risk having American culture damaged by Canadian influence under a free trade arrangement and that he hoped Canada was willing to take a similar risk. After a strong adverse Canadian reaction to his statement, Mr. Yeutter stressed that only those cultural issues affecting Canada-U.S. economic relations need be on the negotiating table.

Details of some of the developments in the negotiations came to light at the end of February when "a senior Canadian official" agreed to be interviewed by a reporter from the Canadian Press. The source reportedly said that both sides were working toward a broad agreement aimed at gradually reducing all tariff and most non-tariff barriers to bilateral trade by the end of the century. The report stated that "the negotiators are involved in detailed talks on every issue involving trade in goods and services. In some non-controversial areas they are even working on the wording of trade-deal clauses." Although Mr. Reisman has stated publicly that the auto pact is not up for negotiation, the source revealed that Mr. Reisman does not believe the safeguards are essential to keep automobile production in Canada. With respect to culture, Mr. Reisman is reportedly prepared to seek protection for some magazines like Macleans and Chatelaine

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while for business-oriented publications, including architects' reviews, engineering bulletins and accountants' guides, he is not. Commercial printing in general is not regarded as an activity that should be protected. Canada's chief negotiator is also said to be prepared to bargain on the issue of unauthorized rebroadcasting of U.S. television signals by Canadian cable companies. Canadian companies might have to pay for the programming under new copyright rules in a free-trade agreement.

A key feature of an agreement would be a mechanism for the settlement of trade disputes that would provide protection from U.S. trade remedy laws such as those which have been brought to bear recently on a number of Canadian exports. According to the unnamed source, discussions are underway for agreement on a common set of rules on subsidies, dumping and other trade-related activities. Canada is proposing a bilateral dispute settlement mechanism including a three-member panel that could make binding arbitration rulings. However, the Americans wish to retain the right to ignore the panel's rulings in some cases. Canadian negotiators are resisting the inclusion of such a provision.

For their part, the Americans would like to be exempt from Canadian restrictions on foreign investment such as Investment Canada reviews of corporate takeovers. The Canadian official noted at the time of the interview that Canadian negotiators had not yet been granted bargaining authority on the investment issue and only investment issues directly related to trade are being discussed.

With respect to agriculture, each country is said to be demanding changes in the other's marketing and subsidy practices but little progress is foreseen in this sector.

A new group called the Canadian Alliance for Trade and Job Opportunities, headed by former Alberta premier, Peter Lougheed and former federal finance minister, Donald Macdonald, has been formed to promote Canada-U.S. free trade. Formation of the group was announced on March 19 and participants include a number of influential business lobby groups such as the Canadian Chamber of Commerce, the Canadian Manufacturers' Association, the Business Council on National Issues and the Canadian Federation of Independent Business. The Consumers' Association of Canada is also among the participants.

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E. Canada - U.S. Trade Actions

The talks did not begin on an auspicious note. On May 22, 1986 the U.S. imposed a 35% tariff on Canada's exports of cedar shingles and shakes (used in the roofing and siding of houses). The Canadian government was not notified in advance and was upset with the U.S. move and the lack of advance warning. The shakes and shingles tariff began on June 6 and will last for five years. It affects exports that were valued at $250 million in 1985, and threatens the loss of several hundred jobs in British Columbia. In one sense the imposition of the tariff is the penalty of success as Canadian exporters have managed to capture 70% of the U.S. market.

Under GATT rules the U.S. is not obliged to compensate for this action as the shakes and shingles tariff was not "bound" - i.e. the U.S. did not agree "not to change" the tariff during the last round of trade negotiations. The Canadian government retaliated by raising tariffs on U.S. exports of computer parts, Christmas trees and publications to Canada of an amount equal to the loss caused by the cedar shingles and shakes tariff. **The lifting of these tariffs was announced on February 18 by Finance Minister Michael Wilson in his budget speech.**

One of the most important trade disputes to arise between Canada and the United States re-emerged in May 1986, when the U.S. Coalition for Fair Lumber Imports filed a petition seeking a 27% duty on Canadian softwood lumber imports. The Coalition, representing U.S. lumber producers, alleged that Canadian producers were being unfairly subsidized through lower stumpage fees. These fees represent the amount paid by loggers to timber owners for the right to harvest their timber. In the United States, an auction system has driven fees significantly higher than those in Canada, particularly in British Columbia. Another investigation three years before had failed to find evidence that lower Canadian stumpage fees represented an unfair subsidy.

On June 26, 1986, the International Trade Commission made a unanimous ruling that Canadian softwood lumber exports were materially harming U.S. producers. The preliminary ruling triggered an inquiry by the

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U.S. Commerce Department to determine whether Canadian lumber producers were being unfairly subsidized through lower stumpage fees. As the October 16 deadline for a Commerce Department ruling drew closer and the U.S. Coalition's countervailing duty request rose to 36%, it appeared that record high U.S. trade deficits were heightening protectionist sentiment and increasing the likelihood of an unfavourable ruling for Canada in the dispute. In an effort to avoid the imposition of a countervailing duty, Canadian trade officials offered on September 30 to raise stumpage fees and other charges levied on lumber by between 8% and 12%. The U.S. petitioners rejected the offer.

On October 16, the U.S. Commerce Department, in a preliminary ruling, found that Canadian softwood lumber exports were being subsidized by 15% of their value. With the date approaching for the final ruling on the matter by the Commerce Department, the Canadian government secured agreement from all the provinces except Ontario to discuss a settlement of the issue with the United States. On December 30, in the last few hours before the final ruling was due, the U.S. petitioners agreed to withdraw their countervail case in return for the imposition by the Canadian government of a 15% duty on softwood lumber exports.

On December 31, President Reagan approved an interim U.S. tax on Canadian lumber imports to last until the Canadian export tax came into effect January 8, 1987. Bill C-37, which would put this export tax into effect retroactively, has been placed before the House. Some controversy surrounds the agreement and the importance to it of a side-letter from U.S. negotiators to the U.S. industry in which it was indicated that future provincial stumpage increases replacing the 15% export tax, must have an equivalent impact on prices at the border.

On October 27, 1986 Canada went before GATT to protest the planned imposition by the United States of a surtax of 0.22% on all imports into that country. At the same time, Canada raised the issue of the 11.7 cents (U.S.) a barrel levy imposed October 17 on imports into the U.S. of oil and oil products. This compares with the rate of 8.2 cents (U.S.) a barrel on domestically supplied oil in the United States.

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Other major U.S. trade actions in 1986 against Canadian goods involved steel forklifts, carnations, sugar products, whole, fresh groundfish and steel tubular products. Complaints were also voiced by U.S. producers of hydro-electricity, uranium, oil, natural gas and steel against Canadian imports of these products.

For its part, Canada imposed what is believed to be the first countervailing duty on an American product, when Revenue Canada levied a preliminary tariff on November 7, 1986 of $1.05 (U.S.) a bushel on U.S. corn imports into this country. In its final ruling on February 2, 1987, Revenue Canada cut the duty by about 20¢ (U.S.) a bushel. However, an unusual public hearing will be held on May 26 to determine whether it would be in the public interest to end the duty. The U.S. Senate unanimously passed a motion on March 26 opposing the duty and called on the U.S. Trade Representative to determine whether the tariff violates the International Subsidies Code and if it does, to initiate an inquiry into possible retaliation.

On February 3, 1987 U.S. Senator John Heinz from Pennsylvania introduced a bill in Congress that would force Canada, Sweden and Taiwan to work out voluntary export restraint agreements for their steel exports to the U.S. American steel producers are concerned about "surges" in imports of steel by these countries whose exports are not at present formally bound under President Reagan's 1984 steel export restraint program.

Legislation was introduced in the U.S. Congress February 5, 1987 by Senator Lloyd Bentsen that would tend to further restrict U.S. imports. The legislation would give the U.S. International Trade Commission greater power by requiring the President to act on Commission recommendations for the imposition of quotas and tariffs. It would also require the administration to increase the number of cases it initiated against unfair foreign trade barriers and would provide for mandatory deadlines for action on these. The bill has 52 other co-sponsors in the Senate and hundreds of amendments to restrict various imports may be added before the bill is passed. The administration is opposed to the bill and has threatened to veto it.

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On February 10, 1987, two U.S. potash companies filed an anti-dumping case against Canadian potash exporters who shipped about $270 million (U.S.) worth of the mineral to the U.S. last year. The U.S. International Trade Commission ruled 5-0, March 23, that these imports from Canada are injuring the U.S. industry. The case now goes before the U.S. Commerce Department for a ruling on what, if any, duty should be applied. U.S. producers are seeking a 43% penalty duty.

Two U.S. steel producers also filed submissions with the U.S. International Trade Commission alleging dumping of steel pipe and tubing in the U.S. by Canadian steel producer IPSCO Inc. of Regina. The U.S. International Trade Commission ruled on March 25 that the line pipe and tube steel imports were not injuring U.S. producers.

Legislation has also been introduced in Congress that would restrict exports of U.S. crude oil and refined oil products. The restrictions would reduce the need for U.S. imports of foreign oil and oil products, disrupting their cross-border flow between Canada and the U.S.

An agreement was reached in March 1987 between Canada and the United States which may reduce the ammunition used by U.S. special interests to justify U.S. protectionism. The deal provides for sharing of customs statistics between the two countries, so as to eliminate the discrepancy in trade data reporting. Because a significant volume of U.S. exports to Canada is not reported when leaving the United States, American export data seriously underestimate the value of U.S. exports to Canada. This implies a larger U.S. trade deficit with Canada than actually exists. Beginning next January, the sharing of import statistics will allow both countries to base their trade balance figures on one set of consistent data. At present, a common set of statistics is released six months after the preliminary data are made available. The delay means the preliminary data are often used rather than the reconciled statistics.

At the GATT talks in Uruguay, the United States threatened to walk out if it did not obtain agreement from other members to include services trade in the negotiations. Developing nations such as India and Brazil fear international competition in services will swamp fledgling

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domestic service industries such as telecommunications, banking and investment.

The GATT ministers finally agreed on September 20, 1986 on an agenda for new talks that will include discussions on trade in both services and food products. However, Canada expressed disappointment at not being able to secure an assurance for speeding-up negotiations on the reduction of food export subsidies. The European Community is seen to have been particularly generous with its food export subsidies but EC ministers appear to be in no hurry to deal with this issue.

PARLIAMENTARY ACTION

It is not certain what Parliament's role would be if any free trade agreement were signed. However, the precedent of the Auto Pact might be illustrative. In 1965, when the Auto Pact began, there was no specific legislation introduced in the House of Commons. Because of this, there was also no real opportunity for the Opposition parties to debate the issue (beyond the scope available during the daily Question Period).

The Liberal government of that time considered the Auto Pact essentially a treaty between two countries with no requirement to refer it to Parliament. The changes in Canada's tariff schedule required by the Auto Pact were accomplished by means of an Order-in-Council. (See Canada Gazette, Volume 99, January 27, 1965; SOR/65-42, Motor Vehicles Tariff Order 1965 (P.C. 1965-99) and SOR/65-43 Tariff Item 950 Regulations (P.C. 1965-100).

Opposition members requested a full debate in the House. For instance on May 10, 1965, four months after the Auto Pact went into effect, it was stated in the House that "Members of this House have had no opportunity to debate it. No Minister of the Crown has given to the House or to the country, a full and definitive explanation of the policy..."(1) The Government defended its actions by pointing out that it was important

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(1) Hansard; May 10, 1965; pages 1111, 1126, 1127.

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to implement the agreement quickly in the interests of the industry as "any delay would have made it difficult to proceed with expansion plans in the forthcoming model year." Also, the government expected Canadian production to increase so there was not an urgent need to present specific legislation to handle any problems arising during the transition phase. (Such legislation was introduced at a later date.)

By contrast, the United States administration had to seek Congressional approval for the agreement, as is customary. This approval was granted (after prolonged debate) and signed into law by President Johnson on October 22, 1965. Similarly, any legislation needed to comply with a Canadian free trade agreement would have to be passed by Congress and a treaty ratified by the Senate.

Prime Minister Mulroney announced June 30 the appointment of the Honourable Pat Carney as Minister for International Trade. Her shift to the new portfolio is widely seen as a move to put a strong player in charge of the free trade negotiations. Mr. Reisman has the government's mandate to negotiate but Miss Carney has Cabinet responsibility to carry the free-trade ball.

An important consideration in the negotiations is the accommodation of provincial interests as many trade issues, including non-tariff barriers, fall within provincial jurisdiction. Although the provincial premiers failed to win a seat at the Canada-U.S. trade bargaining table, Prime Minister Mulroney did agree at a June 2, 1986 meeting with the premiers to hold first ministers' conferences every three months to reassess the progress of the talks. This June 2 meeting was followed by another on September 17. While all provincial premiers initially agreed to support the negotiations in principle, Premier Howard Pawley of Manitoba subsequently called for a suspension of talks pending a resolution of Canada-U.S. trade disputes. Premier David Peterson of Ontario appears to be lukewarm at best on Canada-U.S. free trade negotiations and it seems that both Ontario and Quebec are expecting to obtain virtual rights to veto any agreement.

On November 21, 1986, the provincial premiers were given first-hand information on the progress of the free trade negotiations at

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the First Ministers' Conference in Vancouver when they met behind closed doors with Canada's chief negotiator, Simon Reisman, and Canadian ambassador to Washington, Allan Gotlieb.

The First Ministers met again on March 11, 1987 in Ottawa to receive an update on the progress of the free trade negotiations with International Trade Minister Pat Carney and chief negotiator Simon Reisman in attendance. Items on the agenda were trade in services, intellectual property rights and bilateral trade irritants. The premiers were also asked whether Canada should relax restrictions on U.S. investment in this country as part of a free trade deal.

Several days before the meeting, Minister of State for Federal-Provincial Relations, Senator Lowell Murray, termed Premier Bourassa's "Victoria" ratification formula, essentially giving each region of the country a veto over any agreement, "a non-starter". Senator Murray questioned whether, indeed, any ratification formula would be necessary. The need for such a formula would depend on the kind of trade agreement arrived at, according to the Minister of State for Federal-Provincial Relations. Despite pressure from eight provinces, a ratification formula was not decided upon at the meeting. Premier Bourassa of Quebec and Premier Peterson of Ontario are apparently still seeking the individual power to veto any agreement while other Premiers, such as Howard Pawley of Manitoba, John Buchanan of Nova Scotia, Joe Ghiz of Prince Edward Island and Brian Peckford of Newfoundland, seemed to be looking for an unspecified formal ratification formula. Premier Bill Vander Zalm of British Columbia and Premier Don Getty of Alberta did not ask for a ratification formula. The issue is due to be decided when the premiers meet next in June.

On March 16, 1987 the House of Commons was provided with its first opportunity for debate on the free trade negotiations. During the debate, International Trade Minister, Pat Carney identified the main issues under negotiation. These include: a trade dispute settlement mechanism; the elimination over a 10-15 year period of tariffs in all areas; non-tariff barriers such as import quotas, protectionist technical and health standards, and government purchasing policies; unnecessary customs

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procedures; agricultural subsidies, tariffs and health standards; delineation of subsidy rules to clarify which regional development programs will be allowed; intellectual property rights including protection for new products, services or ideas; services, including engineering, financial consulting, computer services and banking; investment.

The Government put forward a motion reading, "That this House supports the negotiation of a bilateral trading arrangement with the United States, as part of the government's multilateral trade policy, while protecting our political sovereignty, social programs, agricultural marketing systems, the auto industry, and our unique cultural identity". Although the wording of the motion seemed designed to appeal to some amongst the Opposition ranks, the Liberals proposed an amendment which came very close to negating the original government motion. Only the importance of the debate prevented the Speaker of the House from ruling against the amendment. Both the Conservative and New Democratic parties voted against the Liberal amendment while the Conservative majority in the House carried the government motion.

CHRONOLOGY

24 March 1982 - The Senate Standing Committee on Foreign Affairs released the third volume of its report on Canada-U.S. relations. Entitled Canada's Trade Relations with the United States, its major recommendation was that Canada should begin negotiations to ensure bilateral free trade between Canada and the U.S. in all sectors.

13 August 1983 - International Trade Minister Gerald Reagan issued Canadian Trade Policy for the 80's. This is the most comprehensive document ever on Canada's trade policy. Among its themes was a rejection of the Senate's earlier proposal for general free trade. Instead Canada should begin discussions with the U.S. on the possibility of entering into a number of sectoral free trade agreements.

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13 September 1983 - U.S. State Department appointed Mr. James M. Medas as a new deputy assistant secretary with specific responsibilities for Canadian affairs. The State Department regional desk title was simultaneously changed from the Bureau of European Affairs to the Bureau of European and Canadian Affairs. This change was widely interpreted as an upgrading of Canadian interests in Washington.

12 and 13 December 1983 - Canadian and U.S. trade officials met in Washington to begin exploratory talks on sectoral free trade negotiations

30 October 1984 - U.S. Trade and Tariff Act of 1984 was signed into law. It allows the Administration the authority to negotiate a bilateral free trade agreement with Canada.

March 1985 - Prime Minister Mulroney and President Reagan met in Quebec City and issued a "Declaration on Trade" which sought to resolve existing trading irritants and explore possibilities for increased trade between the two countries.

August 1985 - Special Joint Committee on International Relations releases Interim report pertaining to Bilateral Trade with the United States and Canada's participation in Research on the Strategic Defense Initiative. The Committee recommended that immediate bilateral trade discussions with the U.S. should begin while at the same time Canada should also pursue new multilateral negotiations.

6 September 1985 - The Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission) recommended freer trade with the U.S.

26 September 1985 - Prime Minister Mulroney announced that he had told President Reagan that Canada wanted to negotiate "the broadest possible package of mutually beneficial reductions in tariff and non-tariff barriers between our two countries".

8 November 1985 - Simon Reisman was appointed Ambassador and Chairman for the Preparatory Committee for Trade Negotiations.

18 December 1985 - President Reagan referred to Congress for the negotiating authority needed to conduct talks with Canada. Congress had 60 days to respond.

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23 April 1986 - The Senate Finance Committee returned a split vote (10-10) on the Administration's negotiating authority. This allowed the exploratory talks to begin but was not an auspicious launch.

21 May 1986 - Canadian negotiators led by Simon Reisman and U.S. negotiators led by Peter Murphy began preliminary trade negotiations.

22 May 1986 - U.S. Government imposed 35% tariff on Canadian exports of cedar shingles and shakes to the U.S. The tariff became effective June 6, 1986.

2 June 1986 - Prime Minister Mulroney met with the provincial premiers and obtained agreement on a unified approach to the free trade negotiations in return for approval to hold first ministers' conferences every three months to reassess the progress of the negotiations.

3 June 1986 - Canadian government announced retaliatory tariff increases on exports of U.S. computer parts and publications to Canada.

17 June 1986 - The second round of exploratory free trade talks commenced in Washington.

26 June 1986 - The U.S. International Trade Commission delivered a unanimous ruling that Canadian softwood lumber exports were causing material harm to U.S. producers. This triggered an inquiry by the U.S. Commerce Department on the question of whether Canadian producers are being unfairly subsidized.

30 June 1986 - The Honourable Pat Carney was appointed Minister of International Trade.

29 July 1986 - The third round of exploratory free trade talks began at Mont-Tremblant, Quebec.

1 August 1986 - President Reagan signed a Senate bill that allows the United States to subsidize wheat sales to the U.S.S.R. and China.

2 September 1986 - The fourth round of exploratory free trade talks began in Ottawa.

17 September 1986 - The Prime Minister and provincial premiers held the first of their agreed meetings to assess the progress of the negotiations.

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20 September 1986 - The GATT ministers, meeting in Punta del Este, Uruguay, agreed to an agenda for the GATT negotiations.

24 September 1986 - The fifth round of exploratory free trade negotiations began in Washington.

30 September 1986 - Canada offered to raise stumpage fees and other charges levied on lumber if the U.S. will agree to drop its countervailing duty case against imports of Canadian lumber. The offer was declined.

16 October 1986 - The U.S. Department of Commerce found, in a preliminary ruling, that Canadian softwood lumber exports to the U.S. were being subsidized by 15% of their value.

27 October 1986 - Canada protested to GATT the imposition by the United States of an import surtax and an oil levy.

7 November 1986 - Revenue Canada imposed a countervailing duty of $1.05 (U.S.) a bushel on imports of U.S. corn. **This was subsequently reduced by about 20¢ (U.S.) per bushel.**

12 November 1986 - Three days of free trade negotiations began in Ottawa.

21 November 1986 - The provincial premiers met in Vancouver behind closed doors with chief free trade negotiator, Simon Reisman, and Canadian ambassador to Washington, Allan Gotlieb, to discuss the progress of the free trade negotiations.

1 December 1986 - A surtax of 0.22% was imposed on all imports into the United States.

9 December 1986 - Four U.S. Senators arrived in Ottawa to express support for a Canada-U.S. free trade agreement.

16 December 1986 - Three days of free trade negotiations began in Washington.

30 December 1986 - The Canadian Government agreed to impose a 15% duty on softwood lumber exports to the United States in return for the U.S. lumber coalition dropping its countervailing duty case.

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31 December 1986 - President Reagan approved an interim U.S. tax on Canadian softwood lumber imports.

8 January 1987 - The Canadian softwood lumber export tax took effect.

15 January 1987 - Canada's chief free trade negotiator, Simon Reisman, met with his U.S. counterpart, Peter Murphy, for one day of talks in Washington.

16 January 1987 - Canada's chief free trade negotiator, Simon Reisman, met with U.S. Treasury Department officials in Washington to discuss trade in financial services.

19 January 1987 - A Ways and Means Motion was introduced in the House of Commons to impose a 15% duty on softwood lumber exports to the United States, retroactive to January 8, 1987.

21 January 1987 - U.S. Vice-President George Bush and Treasury Secretary James Baker arrived in Ottawa to show support for a free trade agreement.

27 January 1987 - President Reagan promised in his State of the Union address to complete a Canada-U.S. free trade arrangement.

2 February 1987 - Revenue Canada, in a final ruling, cut the duty on imports of U.S. corn by 20¢ (U.S.) per bushel.

3 February 1987 - A bill was introduced in the U.S. Congress that would force Canada to work out a voluntary export restraint agreement for steel.

5 February 1987 - Legislation was tabled in the U.S. Congress that would lock the President into following U.S. International Trade Commission trade recommendations.

10 February 1987 - An anti-dumping case was filed in the U.S. against Canadian potash exports.

18 February 1987 - Lifting of Canadian retaliatory tariffs on imports of U.S. Christmas trees, computer parts and publications was announced.

19-20 February 1987 - Canada's chief free trade negotiator, Simon Reisman, met with his U.S. counterpart, Peter Murphy, for two days of talks in Washington.

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26 February 1987 - A "senior Canadian official" was quoted in the press on the progress of the free trade negotiations.

3 March 1987 - A U.S. cabinet meeting reportedly identified achievement of a free trade pact as one of two major goals for the last two years of the Reagan presidency.

11 March 1987 - The First Ministers met in Ottawa to receive a progress report on the free trade negotiations.

16 March 1987 - Canada's chief free trade negotiator, Simon Reisman, met with his U.S. counterpart, Peter Murphy, for one day of talks in Ottawa.

16 March 1987 - The House of Commons held a debate on the Canada-U.S. free trade negotiations.

17 March 1987 - The House of Commons passed a government motion supporting the free trade negotiations and defeated a Liberal party sponsored amendment.

19 March 1987 - Formation of The Canadian Alliance for Trade and Job Opportunities to promote free trade was announced.

23 March 1987 - The U.S. International Trade Commission ruled that imports of Canadian potash were harming the U.S. industry.

25 March 1987 - The U.S. International Trade Commission ruled that IPSCO line pipe and tube steel imports were not injuring U.S. producers.

26 March 1987 - The U.S. Senate passed a motion opposing the Canadian duty on imports of U.S. corn.

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